The Gruchala Wojtal Group Newsletter

BMO Wealth Management
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2nd Quarter 2016

As the second quarter came to an end, the main issue surrounding the markets was the UK's decision to leave the euro zone and the potential negative ramifications for global growth. We felt that the market was complacent in the weeks and days leading up to the vote and as a result, we were hesitant in placing capital leading up to the vote.

After the negative reaction to the outcome, we used this as an opportunity to purchase quality names for client's underweight equities. These twists and turns in the global economy have sent equities on a violent roller-coaster erasing two 10% corrections in ten months. Now it is in the process of restoring $1.4 trillion that was lost in the days of the aftermath of the Brexit vote.

Government bonds around the world continue to fall and in many cases are in negative territory. The US 10-Year Treasury Note is very close to an all-time low. The only government bonds we currently own are viewed strictly as a hedge to our equity holdings, as we do not believe there is much upside left in government bonds, globally.

The main concern we have (as mentioned last quarter), is that at no other time in modern history, have both government bonds and US equity markets been near their record highs. There is a concerning disconnect here (risk on/risk off), and this conundrum is a testament to the accelerating divergence in sentiments. However, the sectors that have driven the equity markets this year are deemed the "safe sectors" (utilities, telecommunication companies, consumer staples, etc.). Simply speaking, the equity market has been playing defense all year.

This is a direct result of lack of economic growth (consumer demand, cap ex spending, wage growth, etc.). By some measures, global markets have been turned upside down. Investors are relying on income from equities and capital appreciation from bond prices. With these types of events happening, many professional investors remain confounded and defensive in their stance (ourselves included), especially when basing it strictly on valuations.

We feel something has to give; either a sell-off in bonds (higher yields), or a correction in equities to come back to a slower growth (lower inflation). Time will obviously tell. We continue to believe that equity markets will continue to be volatile leading into the middle of the second quarter.

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